

## Andersen Recasting Its Image

Volcker to Lead Reform Effort

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Facing new accusations that it helped Enron Corp. deceive the public about the energy company's financial condition, accounting firm Arthur Andersen said yesterday that former Federal Reserve Board chairman Paul A. Volcker will lead an effort to reform its practices.

Andersen also said it will no longer offer certain consulting services to its audit clients, bowing to criticism that such work can undercut an auditor's independence.

The announcement came one day after a report commissioned by Enron directors alleged that Andersen helped design a web of complicated transactions whose purpose was to get around accounting rules and hide large debts and losses. Andersen, "including the local engagement team and, apparently, Andersen's national office experts in Chicago -- had to surmount numerous obstacles presented by pertinent accounting rules," the report said.

Andersen declined to discuss its Enron work at a news conference yesterday, but it issued a statement saying the Enron report was an effort "to shift blame to others." Andersen said Enron's demise resulted from its own bad business decisions.

"[W]e firmly believe our audit of Enron was conducted with rigor and in full accord with the standards of our profession," Andersen said in the statement.

Andersen chief executive Joseph F. Berardino is scheduled to testify tomorrow before one of several congressional committees investigating Enron's collapse. The new report adds fuel to the investigations, which already included Andersen's shredding of Enron-related records.

"Were they brain dead? Incompetent? What on earth has happened?" Sen. Byron L. Dorgan (D-N.D.) said yesterday on NBC's "Meet The Press."

The report is so critical of Andersen that it seems to obligate Enron's board of directors to sue Andersen "on the grounds that it was not simply negligent, but it was designing these transactions with an interest in hiding the economic results," said John C. Coffee Jr., a law professor at Columbia University.

Andersen, already facing investor lawsuits and probes by the Justice Department and the Securities and Exchange Commission, as well as congressional panels, sought yesterday to restore confidence in the firm.

Berardino said that when Andersen serves as outside auditor of a publicly traded company, it will no longer perform information technology or internal audit services for that client. He also promised to follow whatever recommendations Volcker and other members of a soon-to-be-created internal oversight board produce.

Volcker, 74, who is chairman of the International Accounting Standards Committee, said he would not be paid for the Andersen assignment. "My interest is well beyond Arthur Andersen," he said. "I think accounting and auditing in this country is in a state of crisis."

The report portrayed Enron as addicted to accounting ruses and Andersen as its enabler.

The report noted that investigators were unable to get Andersen's version of events. Investigators had limited access to Andersen's records, and Andersen did not allow them to interview key personnel, the report said. Andersen disagreed, saying it offered to make its people available but that the special panel overseeing the investigation wouldn't cooperate.

For much of its recent history, Enron owed its appearance of success in large part to dealings with related partnerships that bought assets Enron no longer wanted and took on debts that Enron did not want investors to see, the report said.

The assets, often risky or deteriorating, included power plants in Turkey and Spain, investments in an Internet business and other start-up companies, and oil and gas properties.

"Many of the most significant transactions apparently were designed to accomplish favorable financial statement results, not to achieve *bona fide* economic objectives," the report said.

By last fall, Enron and Andersen could no longer justify some of the elaborate accounting contortions, and Enron was forced to correct its books going back to 1997. The sudden disclosure of previously invisible debts and losses shattered investors' trust and helped send Enron spiraling into bankruptcy.

Andersen was supposed to serve as a watchdog, assuring the public that Enron's financial statements presented a fair picture of the Houston energy trader's finances.

In "virtually all" of the transactions that led to Enron's devastating correction, "Enron's accounting treatment was determined with extensive participation and structuring advice from Andersen," the report said.

A group of off-the-books partnerships known as the Raptors were seen by many within Enron "as a triumph of accounting ingenuity by a group of innovative accountants," but they were "little more than a highly complex accounting construct that was destined to collapse," the report said.

"There is no question that Andersen accountants were in a position to understand all the critical features of the Raptors and offer advice on the appropriate accounting treatment," the report said. "Indeed, there is abundant evidence that Andersen in fact offered Enron advice at every step."

If not for the improper Raptor deals, Enron would have reported pre-tax earnings of \$429 million, instead of the \$1.5 billion the company claimed during the five fiscal quarters that preceded Enron's bankruptcy filing.

The report said Andersen charged more than \$1 million for its work on the Raptors, "yet it apparently failed to provide the objective accounting judgment that should have prevented these transactions from going forward."

Andersen spokesman Charlie Leonard disagreed. "We were the plumbing inspector. We were not the architect; we were not the general contractor," he said.

The report indicated that Andersen knew Enron had for a time booked income that accounting principles generally prohibit.

Accounting rules generally prohibit a company from counting an increase in the value of its own stock as income, the report said. However, a partnership called Jedi held 12 million shares of Enron stock, and Enron recorded income resulting from appreciation in the value of those shares, the report said.

Enron and Andersen apparently developed a formula in 1996 for computing how much income Enron could record from the appreciation of that stock, the report said. Andersen records from the first quarter of 2000 indicate that Enron recorded \$126 million in Enron stock appreciation during that period, the report said. By the third quarter of 2000, the report said. Andersen records showed that someone -- Andersen, Enron, or both -- had decided that growth in the stock's value could no longer be counted on Enron's income statement, the report said.

Later, when Enron stock held by Jedi declined in value, Enron did not record its \$90 million share of the loss. Enron accountants said they were told by Andersen that Enron was not recording gains from the stock and therefore should not record losses, the report said.

The report said Andersen billed Enron \$5.7 million from 1997 to 2001 -- above and beyond its regular audit fees -- for advice on transactions involving partnerships known as LJM and Chewco.

Andersen chief executive Berardino has testified on Capitol Hill that Andersen was not given crucial information that would have shown that Chewco, which accounted for much of Enron's November correction, should have been included in Enron's financial statements since 1997. The Enron report said the investigation was unable to confirm or disprove Andersen's account.

A Nov. 2, 2001, memo by one of the Andersen auditors, which was obtained by The Washington Post, said Andersen asked an Enron executive for Chewco documents at the time of the transaction. "but [we] were advised that the documents were those of a third party and Enron does not have access to such documents."

An Andersen spokesman said yesterday that Andersen relied on representations from Enron's management when it passed judgment on Chewco in 1997.

Auditing standards say that management's representations "do not constitute sufficient audit evidence."

"Obtaining such representations complements but does not replace other auditing procedures that the auditor should perform," says an auditing standards text by the American Institute of Certified Public Accountants. That means that auditors need to look for documentation, not just take the word of company managers.

When auditors are unable to obtain all the information they need, they should note in their audit report that their opinion was subject to limitations, said former SEC chief accountant Lynn Turner, now director of the Center for Quality Financial Reporting at Colorado State University.

The report said also there was no evidence Andersen communicated to the Enron board certain concerns that Andersen partners discussed among themselves.

Enron's disclosures about the partnerships were generally relegated to footnotes in financial statements that Andersen approved. The report said the footnotes "glossed over" important details. For example, one omitted fact, which "likely would have been relevant to investors," the report said, was that Enron had placed a trade in effect betting against its own stock.

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